



We need to change the way we make policy decisions



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WHAT SEEMS to have been overlooked in the maelstrom of economic debate of recent months is that while we have lost our sovereignty, so to speak, on the broad parameters of budgetary strategy, we have not lost our sovereignty to make microeconomic policy choices.

By microeconomic policy, I mean the internal dynamics of the economy – the regulatory environment, welfare, labour market policy, the broad agenda of distribution within the economy and so on.

We have not invested enough energy on policy framing in these areas and are not showing much awareness of the need to invest in capacity for the future. This is a mistake – and will be instrumental in ensuring we don't capture the gains that are potentially there as the economic cycle turns.

Good microeconomic policy choices require an overall framework that guides what you want to achieve (efficiency versus equity choices in social policy, for example), and a commitment to considering not just the specific impact of a policy change, but also the broad spillovers from that change to other domains.

Above all, we need the evidence to support choices – better data, better policy design. Policy setting in Ireland rarely has the right combination of these traits. As a result, we get policy-on-the-hoof and a lack of consideration for the wider impact of policy choices (or non-choices).

This is an under-debated aspect of our downfall and, more than ever, we will need to rectify it. Just making the changes in the Budget – and the underlying National Recovery Plan – won't satisfy the International Monetary Fund/European Central Bank when we hand up our copybooks for grading every quarter. They will want to know the logic of our choices, the potential for impact, the effective "plan B" if things do not go to plan.

A good example from the Budget this week (apart from the idiocy of making an announcement on this in a Budget speech) is the reduction in the minimum wage. Taking

something away that has been awarded hurts a lot more than not giving it in the first place – and having one of the highest minimum wages in the western world is something that should not have happened in the first place.

Creating a minimum wage policy that targeted median wages in a booming economy was a terrible decision which was always going to come home to bite. Clever policy design can take the heat out of policy "untouchables".

Despite the moves in Budget 2011, we still have a lot of knots and kinks in the tax and welfare schedules, with the potential for traps. We do research the distributional impact of policy through models such as the ESRI Switch, but we rarely consider the behavioural responses of people – labour supply, disincentive effects of welfare and so on.

The focus on individual welfare scheme payments in the budget, rather than the total welfare received, makes it very difficult to see the wood for the trees. Comparing this with the UK, where the policy is a simple one that pegs maximum welfare benefits to the average industrial wage, you can immediately see how sharp policy design slices through arguments and nullifies the debate between those who think welfare is too generous and those who believe it is too meagre.

Similarly, we appear to have fluffed the opportunity to reform higher education funding. We have introduced a higher fee for the first student in a family going to higher education, and left the fee as was for the second and subsequent student.

First, what has the fee charged got to do with family size? Second, why do we continue to base such policies on parental – rather than student – circumstances?

Finally, the Budget 2011 strategy benefits those families with students already in higher education – who are predominantly from more socially advantaged families.

An alternative uses higher education policy to support the sector but in doing so creates a set of labour market levers that can be pulled when needed. Government can, for example, change the income level at which students repay their student loans to promote low-paid – but worthy – occupational choices.

Active labour market policy for the jobs crisis is addressed in the Budget. The academic economics literature is rich with examples of well-designed, well-crafted labour market strategies for the unemployed, particularly internships for young graduates.

However, many commentators criticise such policies as flabby and unfocused, largely because Fás and the evidence of significant spending per trainee, for no measurable impact, taints the Irish experience.

I want to be supportive of the announced schemes but they will fail – in reality and in public perception. If they are an "old for new" swap with no evaluation and poor design, then

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they are worse than doing nothing.

There is a glimmer of hope. We need to take the opportunity the National Recovery Plan presents to change how we do the policy business – multiannual budgetary processes which create the space for strong and inspired policy choices. My hope is that the IMF monitoring will perhaps provide the right incentive to do things differently.

And Budget 2011 did make some bright moves – the changes in the transit taxes for air travel is framed like an experiment – change designed to have impact, reversible if it fails, embedded if it works. We need to get into the same thought-space on microeconomic policy on all domains.

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